Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
Seeks Comment on Certain of the Commission's Rules	)	
Relating to High-Cost Universal Service Support	)	
	)	

NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION REPLY COMMENTS

NATIONAL TELECOMMUNICATIONS
COOPERATIVE ASSOCIATION

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SUMMARY

The National Telecommunications Cooperative Association (NTCA) urges the Federal-State Joint Board on Universal Service (Joint Board) to recommend that the Federal Communications Commission (Commission or FCC):

(1) refrain from applying a forward looking economic cost model for determining high-cost universal service support for rural ILECs;

(2) retain the current definition of a "rural telephone company" at this time for purposes of determining which rural ILECs are eligible to receiving rural high-cost universal service support;

(3) allow the rural ILEC USF embedded cost methodology to continue beyond the five-year RTF plan for purposes of determining rural ILEC high-cost support;

(4) eliminate the identical support rule and require CETC support to be based on CETC costs, not ILEC's costs;

(5) continue to calculate rural ILEC support based on the individual carrier's study area average costs;

(6) retain the current corporate operations expense adjustment;

(7) continue to provide local switching support to rural telephone companies with 50,000 or fewer lines;

(8) modify the safety valve rule to provide carrier support for an acquiring carrier's first year investment in acquired exchanges; and

(9) expand the base of USF contributors to include all cable, wireless and satellite providers of broadband Internet access and facilities-based and non-facilities-based VoIP and IP-enabled service providers.

Rural ILECs in many instances are the sole providers of high-quality, ubiquitous telecommunications service throughout their rural service territories. Rural ILECs have made significant investments in the rural high-cost portions of the Nation under an existing universal service support system that allows for the full recovery of certain amounts of a carrier's

embedded costs. Use of the RTF's recommended embedded cost mechanism should be retained for rural telephone companies. There is no showing that use of a FLEC model will provide a sufficient level of support or otherwise promote the goals of universal service. The use of questionable FLEC models has little support in the record. Paries understand that FLEC could result in insufficient support which would threaten the ability of rural ILECs to offer basic and advanced services to their customers, schools, libraries, and health care facilities. A "one-size fits all" technology-mixed FLEC model for over 1000 rural telephone companies would be completely at odds with the intent of Section 254 of the Act.

The Joint Board should urge the elimination of the "identical support rule" and adopt corrective measures proposed here by NTCA.

NTCA recommends that support to wireless CETCs be more closely tied to wireless costs. Requiring large wireless carriers to receive support based on the non-rural mechanism and allowing smaller wireless carriers the option of demonstrating their costs or using a model that reasonably approximates their costs can accomplish this goal. The NTCA alternative is summarized as follows:

(1) Apply a similar size criteria in the statutory definition of a "rural telephone company" to determine whether a wireless CETC should be treated like a "rural telephone company" (e.g., a similar "rural wireless carrier" criteria would include a wireless provider with less than 100,000 connections within a state);

(2) Allow all wireless CETCs that **do** meet this "rural wireless carrier" criteria the option of receiving per-line support based on a reasonable small **rural wireless carrier proxy** mechanism for that state **or** demonstrate their wireless costs in order to determine whether the CETC is eligible to receive support and at what per-line support amount based on the wireless CETC's own costs. (The Commission would adopt a rural wireless carrier proxy model.)

(3) Allow all wireless CETCs that **do not** meet the "rural wireless carrier" criteria the option of receiving per-line support based on the **non-rural** high-cost proxy

> mechanism for that state **or** demonstrate their wireless costs in order to determine whether the CETC is eligible to receive universal service support and at what per-line support amount based on the wireless CETC's own costs.

This alternative is proposed to address the fact that CETCs with more than 100,000 connections within a state account for $25.3 million or 24 percent of $105.6 million in projected rural high-cost support earmarked for CETCs in the fourth quarter of 2004. The growth of the fund can be curbed by adjustments to rules that automatically provide these carriers the same per line support that incumbents must prove.

NTCA believes that the proposed rule changes will give the Commission more effective tools to provide "sufficient" support while insuring the long term sustainability of the fund and preventing excessive growth.

A decision on a mechanism for the future funding of support for rural telephone companies is part of a wider set of issues, including reform of intercarrier compensation, the President's pronouncement that broadband should be made available to all Americans by 2007 and the possibility that the next Congress will begin deliberations over a rewrite of the Communications Act. The Joint Board should retain the existing embedded cost mechanism in the interest of preserving a stable environment for investment in high-cost rural areas and the maintenance of universal service in the interim during which fundamental changes in the industry could occur. It would be counter-productive to engage huge resources in a debate over embedded cost versus forward-looking economic costs during a time when other changes may make this debate a moot issue.

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NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION
REPLY COMMENTS

The National Telecommunications Cooperative Association (NTCA)[1] hereby files its reply comments in response to the Federal-State Joint Board on Universal Service (Joint Board) request for comment on issues recently referred to it by the Federal Communications Commission (Commission or FCC) relating to the high-cost universal service support mechanisms for rural ILECs and the appropriate rural mechanism to succeed the five-year plan adopted in the Rural Task Force (RTF) Order.[2] Silence on any positions or proposals raised by parties in this proceeding connotes neither agreement nor disagreement with their positions or proposals.

[1] NTCA is the premier industry association representing rural telecommunications providers. Established in 1954 by eight rural telephone companies, today NTCA represents 560 rural rate-of-return regulated incumbent local exchange carriers (ILECs). All of its members are full service local exchange carriers, and many members provide wireless, cable, Internet, satellite and long distance services to their communities. Each member is a "rural telephone company" as defined in the Communications Act of 1934, as amended (Act). NTCA members are dedicated to providing competitive modern telecommunications services and ensuring the economic future of their rural communities.
[2] *See* FCC Public Notice, Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support, CC Docket No. 96-45, FCC 04J-2, (rel. August 16, 2004) (Public Notice).

I. INTRODUCTION

In its initial comments, NTCA urged the Joint Board to recommend that the Commission allow the current rural embedded cost methodology to continue beyond the five-year RTF plan for purposes of determining rural ILEC high-cost support. NTCA also recommended that the current definition of a "rural telephone company" be retained at this time for purposes of determining which ILECs are eligible to receive rural embedded high-cost universal service support. NTCA further recommended that the identical support rule be eliminated, that rural ILEC support continue to be based on the individual carrier's study area average costs, and that the corporate operations expense adjustment be retained. In addition, NTCA recommended that local switching support (LSS) to rural ILECs be continued and the parent trap rule be either eliminated or modified to provide acquiring carriers' support for their first year investment in acquired exchanges. Lastly, NTCA recommend that the base of universal service fund (USF) contributors be expanded to include all cable, wireless and satellite providers of broadband Internet access and facilities-based and non-facilities-based VoIP and IP-enabled service providers. None of the initial comments filed by other parties has provided any reason for NTCA to change its recommendations in this proceeding.

II. THE JOINT BOARD SHOULD RECOMMEND THE CONTINUED USE OF THE EMBEDDED COST METHODOLOGY FOR DETERMINING HIGH-COST SUPPORT FOR RURAL ILECS

The current rural ILEC embedded cost methodology should continue beyond the five-year RTF plan for purposes of determining rural ILEC high-cost support. The rules permit rural carriers to recover their actual investment in the total network facilities needed to provide comparable rates and services to customers living in rural and high-cost areas. High-cost support reflects the legitimate costs of rural carriers serving their **entire** rural study areas, an obligation that is imposed on these companies as carriers of last resort. Without support for the entire actual cost of the network, many consumers living in rural high-cost regions of the United States would not have access to affordable and comparable telecommunications services.

A majority of the parties filing comments agree that the embedded cost methodology should continue beyond the five-year RTF plan for purposes of determining rural ILEC high-cost support. These parties include OPASTCO, ITTA, NECA, USTA, Verizon,[3] Sprint,[4] NASUCA,[5] CenturyTel, ALLTEL,[6] TDS, Fairpoint Communications, Frontier and Citizens ILECs, the Home Telephone Company Inc. and PBT Telecom Inc., the Plains Rural Telephone Companies, Rural Oklahoma Telecommunications Coalition, Tri-County Telephone Association Inc., Coalition of State Telecommunications Associations and Rural Telephone Companies (comprised of the state associations from California, Colorado, Oregon and Washington, and certain ILECs from Alabama), Texas Statewide Telephone Cooperative, Inc., Regulatory Commission of Alaska, Alaska Telephone Association, Alexicon, Interstate Telecom Consulting Inc., TCA, GVNW, ICORE, and JSI.

Wireless carriers conversely propose a "one-size fits all" forward-looking economic cost (FLEC) model that would be applied to all wireless competitive local exchange carriers (CETCs), landline CETCs and rural ILECs for purposes of determining per-line rural high-cost

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[3] Verizon recommends that all rural ILEC serving less than 100,000 access lines should remain under the current embedded high-cost universal service support mechanism. Verizon Comments, p. 3.
[4] Sprint recommends as part of a comprehensive reform of the federal universal service system, that the FCC should continue to use actual costs for rural carriers but should initiate a process to move toward forward-looking costs by benchmarking the average costs incurred by rate-of-return ILECs against those incurred by similarly-sized, similarly situated rural price cap ILECs. Sprint Comments, pp. 3-4.
[5] NASUCA states that the *Rural Difference* shows substantial variation in the cost structure of the small carriers to allow these carriers to remain on embedded costs while the FCC develops a forward looking cost model for smaller carriers during this time period that recognizes the differences among smaller carriers. NASUCA Comments, p. 25.
[6] ALLTEL Comments, pp. 6-9.

support.[7] None of the FLEC proponents, however, provide any details of the component parts of this hypothetical one-size, mixed-technology FLEC model based exclusively on speculative costs. They also fail to show or are unable to show how FLEC will accomplish the universal service goals of comparability, sustainability and sufficiency.[8] This is not a surprise. After two years of careful consideration and evaluation of the non-rural high-cost FLEC proxy model for use in calculating high-costs support for landline rural ILECs, the Rural Task Force (RTF) concluded that the adoption of this one-size fits all FLEC model would produce extremely large differences in universal service support for rural consumers.[9] The RTF convincingly demonstrated that the public would not benefit from the use of a hypothetical FLEC proxy model to determine support for more than 1,000 highly diverse rural ILECs. The RTF's conclusions are addressed and supported by professor Lehman's economic analysis in "False Premises, False Conclusions."[10]

A rural ILEC support model based on FLEC output costs fails to account for much of the cost already incurred in the build-out of a network in rural areas.[11] Indeed, the RTF found in its study of the non-rural carrier FLEC model that:

> applying the [FLEC model] directly to the task of sizing the national Rural Carrier high cost fund and using the same policy mandates adopted for non-Rural Carriers would reduce available support to Rural Carriers from the current $1.553 billion to $451 million, a reduction of over one billion dollars…[W]e conclude that the non-rural method and [FLEC model] developed for the non-Rural Carriers are not the appropriate tools and application for Rural Carriers and will not produce a

[7] See the Comments of Western Wireless, CTIA, and Dobson Cellular.
[8] *See,* "False Premises, False Conclusions," by Dale Lehman submitted in CC Docket No. 96-45 (August 5, 2004). No one has yet made the case that the public will benefit by the use of a forward-looking economic cost proxy model to determine rural telephone company support ("False Premises).
[9] *A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies,* White Paper #4 (September 2000)(RTF White Paper #4).
[10] *See generally,* "False Premises."
[11] *See,* Comments of the Rural Telephone Coalition, CC Docket Nos. 96-45 and 97-160, DA 98-715, May 15, 1998 at 12.

> sufficient universal service mechanism for Rural Carriers that is in the public interest and consistent with the principles of the 1996 Act.[12]

The Commission and Joint Board agreed with these findings when they FCC adopted a modified version of the RTF's recommended embedded cost model for determining high-cost support for rural carriers on May 10, 2001.[13] Today, the conditions under which rural ILECs operate have not changed sufficiently to necessitate any shift away from the embedded cost approach for determining rural ILEC high-cost universal service support.

The proponents of FLEC fail to point out that imposing a FLEC model on rural telephone companies would likely have a significant detrimental price effect on rural consumers. Professor Lehman has drawn an example from the health care field that is instructive. In 1983, the federal government instituted a similar system of diagnostic related groups (DRGs), which attempted to standardize medical treatments to provide cost-reducing incentives to medical providers. Since this program has been implemented health care prices for consumers have increased significantly and the implementation and operation of the program has been very costly and administratively burdensome. In addition, any cost reductions that the program may have achieved may have come at the expense of the quality of services delivered.[14] Imposing a one-size FLEC model on rural ILECs would very likely result in similar price increase and service quality consequences on consumers living in rural areas.

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[12] *See Rural Task Force Recommendation*, p. 30, Letter from William R. Gillis, Chair, Rural Task Force, to Magalie Roman Salas, FCC, dated September 29, 2000 (RTF Recommendation).

[13] *In the Matter of the Federal-State Joint Board on Universal Service*, CC Docket 96-45, *Multi-State Group (MAG) Plan for the Regulation of Interstate Services of Non-Price Cap LEC Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, FCC 01-157 (rel. May 23, 2001)(RTF Order).

[14] *See* NTCA's Initial Comments, Attachment A at p. 17, "The Role of Embedded Cost in Universal Service Funding," by Professor Dale E. Lehman. (Lehman Paper).

As Professor Lehman correctly states, cost minimization cannot be the primary focus of the Joint Board's review of the modified embedded cost mechanism.[15] The Act's requirement of "sufficiency" and "predictability" makes cost minimization important but only insofar as the goal of efficiency does not interfere with the goals of ensuring that consumers in rural areas receive "quality services" at "just, reasonable, and affordable" rates, and rates and services that are comparable to those provided in urban areas.[16] Because FLEC models focus on cost minimization, a one-size fits all rural carrier FLEC model would be unsuitable in promoting investment in rural areas and incapable of ensuring comparable rates and services for rural consumers.

Rural ILECs in many instances are the sole providers of high-quality, ubiquitous telecommunications service throughout their service territories. Rural ILECs have made significant investments in the rural high-cost portions of the nation under an existing support system that allows for the full recovery of certain amounts of a carrier's embedded costs. If a substantial portion of these costs is no longer recovered through the use of a FLEC model, then these costs will become stranded investment.[17] Basing rural ILEC support on a FLEC model will halt future investment needed to modernize the telecommunications infrastructure in rural areas and it will jeopardize the ability of rural carriers to service debt for plant facilities already constructed and lawfully approved by regulators.

If rural ILECs lose their ability to maintain their networks and existing investments become stranded, some consumers living in rural high-cost areas would very likely be deprived

[15] *Id*.
[16] Section 254(b).
[17] The term "stranded investment" typically means plant facilities that are no longer in use and have not fully recovered their costs. However in the context of this proceeding, stranded investment can result in plant facilities that are not fully recovering their costs but are still in use.

of basic service.[18] Insufficient support would also threaten the ability of rural ILECs to offer advanced services to their customers, schools, libraries, and health care facilities. Given the Act's goal of preserving and advancing universal service to ultimately provide consumers with access to advanced telecommunications and information services, imposing a one-size, technology-mixed FLEC model on over 1000 rural telephone companies would be completely at odds with the intent of Section 254 of the Act.

III. THE ACT'S "RURAL TELEPHONE COMPANY" DEFINITION SHOULD BE RETAINED FOR LANDLINE INCUMBENT LOCAL EXCHANGE CARRIERS

The Joint Board has sought comment on whether it should change the current use of the statutory definition of a "rural telephone company" for determining which landline ILECs are eligible to receive rural high-cost USF support under the rural embedded cost methodology.[19] Some parties recommend changing the definition in order to reduce the number of rural ILECs that receive rural high-cost universal service support and thus reduce the future growth of the high-cost fund.[20] NTCA and several other parties disagree and urge the Joint Board to refrain at this time from recommending a change to the use of the statutory definition of a "rural telephone company" for purposes of determining which landline ILECs qualify to receive high-cost support based on embedded costs.[21]

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[18] In *Smith v. Illinois*, the Supreme Court stated that "proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction" to determine whether rates would result in confiscation. The Court held that when distinct jurisdictional limits exist as to the determination of reasonable rates, some form of jurisdictional separations must occur. The Court established that "reasonable measures [are] essential" and indicated that such measures should not "ignore altogether the actual uses to which the property is put." The Joint Board's actions in this proceeding should therefore take into consideration state commission jurisdiction and the separation of rural ILEC property and expenses between interstate and intrastate operations in order to avoid issues of preemption and confiscation. *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 51 S.Ct. 65 (1930).

[19] Public Notice ¶ 56.

[20] See the comments of Dobson Cellular, p. 4, Verizon p. 8, NASUCA, p. 20, Surewest Communications, p. 2, Western Wireless, p. 32.

[21] See the Comments of NTCA, p. 4, OPASTCO, p. 3, ITTA, p. 17, USTA, p. 6, Sprint Corp., p. 7, TDS, p. 13, Frontier and Citizens ILECs, p. 2, Sandwich Isles Communications, Inc., p. 12, JSI, p. 9, Coalition of State

Congress distinguished "rural telephone companies" from "non-rural telephone companies" in Section 153(37) of the Act. Congress took into careful consideration the key differences between rural and non-rural local exchange carriers, namely, small customer bases and higher costs, when it established the definition of a rural telephone company. This definition was clearly developed with an understanding that different approaches might be needed to preserve and promote universal service in areas served by these companies.

Use of the definition is consistent with other portions of the Act. Section 214(e) establishes the terms and conditions under which universal service support will be available to rural ILECs and their competitors. This section requires that before designating a CETC in an area served by a rural telephone company, a state must find that the designation is in the public interest. This public interest determination is not required for non-rural telephone companies. Congress therefore believed that all carriers that fall under the current statutory definition of a rural telephone company should have a specific public interest determination before any competing carriers are granted CETC status for purposes of receiving rural high-cost universal service support. The Joint Board should acknowledge this concern by recommending retention of Congress' definition of "rural telephone company" for carriers eligible for the rural mechanism. Furthermore, recommending a change to the rural telephone company definition would only reduce the size of the fund by 11 percent.[22]

Telecommunications Associations and Rural Telephone Companies, p. 3, Alltel, p. 2, and Alexicon Telecommunications Consulting, p. 13.

[22] OPASTCO Comments, p. 5, in 4th Quarter 2004, ILEC study areas with 100,000 access lines or more will receive $69.8 million out of a total $632.6 million.

IV. THE IDENTICAL SUPPORT RULE SHOULD BE ELIMINATED AND A CRITERIA BASED ON SIZE SHOULD BE APPLIED TO WIRELESS CETCs SEEKING "RURAL" HIGH-COST SUPPORT

A. The "Identical Support" Rule Violates The Principle Of Competitive Neutrality.

Nextel, Sprint PCS and other large wireless carriers are not "rural telephone companies" as defined by the Telecommunications Act of 1996.[23] Because of the identical support rule, however, these large wireless carriers are able to circumvent this fact and receive substantial amounts of high-cost tied to "rural telephone company" cost which have no relationship to their costs. This identical support rule is the root of the escalating fund problem.[24]

Western Wireless,[25] CTIA[26] and General Communications Inc., (GCI)[27] argue that the identical support rule is required by law and is "competitively neutral." They are wrong on both counts. In the Commission's First Report and Order, in this docket, it found that the identical support rule at the time was merely the least burdensome method for providing CETCs with

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[23] Based on a Joint Board recommendation, in 1997 the Commission adopted, for universal service purposes, a definition of rural carrier that mirrored the definition of "rural telephone company" found in section 3(37) of the Act. *See* 47 U.S.C. § 153(37); *Universal Service First Report and Order*, 12 FCC Rcd at 8943-44, ¶ 310. Pursuant to this definition, a rural telephone company is a local exchange carrier operating entity to the extent that the entity:

> (A) Provides common carrier service to any local exchange carrier study area that does not include either:
>
> > (i) Any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or
> >
> > (ii) Any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;
>
> (B) Provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;
>
> (C) Provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or
>
> (D) Has less than 15 percent of its access lines in communities of more than 50,000 on February 8, 1996.

[24] Large wireless carriers are currently receiving per-line support based on the costs of many small, landline, incumbent rural telephone companies serving less that 50,000 customers in such states as Alabama, Iowa, Michigan, Mississippi, Montana, North Dakota, South Dakota, Texas, Virginia, West Virginia, Washington, and Wisconsin.

[25] Western Wireless Comments, p. 9.

[26] CTIA Comments, p. 14.

[27] GCI Comments, p. 15-25.

support.[28] In fact, the rule is not part of the Act and the Commission most certainly can eliminate it to ensure that support is sufficient and used for the purposes intended in Section 254 of Act.

The identical support rule is not competitively neutral. The rule allows CETCs to receive the same per-line support as rural ILECs based on the ILEC's costs.[29] Thus it is entirely possible for a large wireless CETC to receive rural support even if it can be extremely profitable in rural markets without support or has plentiful alternative incentives to build-out its network in a rural ILEC's service area. Indeed, the District Court in Nemaha County, Kansas, recently overturned a decision by the Kansas Commission that would have made state universal service support received by rural ILECs portable to CETCs on a per-line basis. The court determined that providing support to a CETC based on the costs of an ILEC is not competitively neutral. The Court found that:

> The Order of the [Kansas Corporation] Commission violates the [state's] statutory requirement to make distributions in a "competitively neutral manner," because the Commission has failed to evaluate all the necessary cost/expense information from all providers. The LEC's [sic] are different in structure and treatment then the wireless providers. Attempting to establish competitive neutrality without evaluating all providers' costs and expenses, means that the [Kansas Corporation] Commission has compared apples to oranges. In order that its orders are competitively neutral, the [Kansas Corporation] Commission must compare the same units of measure.[30]

Moreover, wireless CETCs are exempt from rate and state entry regulation; this allows them to avoid the substantial costs associated with carrier-of-last-resort obligations, service

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[28] *In the Matter of the Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, FCC 97-157, First Report and Order, 12 FCC Rcd 8933, ¶ 289 (rel. May 8, 1997)(First Report and Order).
[29] 47 C.F.R. § 54.307.
[30] *Bluestream Telephone Company, et al vs. Kansas Corporation Commission,* In the District Court of Nemaha County, Kansas, Case Nos. 01-C-39, 01-C-40, 03-C-20, and 2004-CV-19, Memorandum and Decision (rel. April 30, 2004).

quality requirements, cost-studies, rate cases, accounting obligations, separations requirements, audit reviews, and other state and federal regulatory mandates. As Commissioner Abernathy acknowledges:

> Requiring incumbent LECs, but no one else, to comply with costly regulations and to open their books to competitors raises obvious questions of competitive neutrality.[31]

This regulatory disparity has created a dangerous incentive for wireless carriers to seek CETC status in rural high-cost areas where they already provide ancillary wireless service to ILEC customers.

B. The "Identical Support" Rule Is Not In The Public Interest.

Even if the management of a large wireless carrier knows that their costs are low enough to compete effectively without the additional support, they are compelled by the identical support rule to seek CETC designation so as to maximize profits and avoid lost opportunities to obtain support. This has led to a dramatic increase in CETC rural high-cost universal service support over the last two years. There is no requirement that the customer addresses used by mobile CETCs to identify service locations, must match names or involve service in the ILEC's service area. In fact, the South Dakota Telecommunications Association has demonstrated that Western Wireless sought portable per-line universal service support for 30,108 working loops on the Pine Ridge Reservation in South Dakota in the first quarter 2003, when according to

[31] Separate Statement of Commission Kathleen Q. Abernathy, Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286, Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301, and 80-286, FCC 01-305, In the Matter of 2000 Biennial Regulatory Review – Comprehensive Review of Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2, Amendments to the Uniform System of Accounts for Interconnection, Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, Local Competition and Broadband Reporting, p. 2 (rel. November 5, 2001).

2000 census data, the reservation had 14,068 residents living in 3,922 housing units.[32] When a wireless CETC receives universal service support under these circumstances it is very likely a pure windfall.[33]

C. The Board Should Recommend Moving Away From The Identical Support Rule With Alternatives That Provide Similar Cost Based Support For Rural Wireless Carriers

To correct this growing problem, NTCA believes that the Board should recommend the following proposed changes to the FCC's universal service rules:

(1) Apply a similar size criteria in the statutory definition of a "rural telephone company" to determine whether a wireless CETC should be treated like a "rural telephone company" (e.g., a similar "rural wireless carrier" criteria would include a wireless provider with less than 100,000 connections within a state);

(2) Allow all wireless CETCs that **do** meet this "rural wireless carrier" criteria the option of receiving per-line support based on a reasonable small **rural wireless carrier proxy** mechanism for that state **or** demonstrate their wireless costs in order to determine whether the CETC is eligible to receive support and at what per-line support amount, based on the wireless CETC's own costs. (The Commission would determine a rural wireless carrier proxy model.)

(3) Allow all wireless CETCs that do **not** meet the "rural wireless carrier" criteria the option of receiving per-line support based on the **non-rural** high-cost proxy mechanism for that state **or** demonstrate their wireless costs in order to determine whether the CETC is eligible to receive universal service support and at what per-line support amount based on the wireless CETC's own costs.

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[32] Comments of the South Dakota Telecommunications Association, WT Docket No. 02-381 (filed February 3, 2003).

[33] Salomon Smith Barney, Wireless Services, USF Subsidies May Significantly Improve Subscriber Economics for Rural Carriers, Multi-Company Note, p. 1 (January 21, 2003)("USF is the single-most important opportunity for rural wireless carriers to improve their return on capital.") *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 412 (U.S.C.A. 5th Cir. 1999) ("Excessive funding may itself violate the sufficiency of the Act.")

Based on USAC[34] quarterly projections in fourth quarter 2004, $25.3 million in rural support will be distributed to CETCs with more than 100,000 connections within a state.[35] This accounts for 24 percent of $105.6 million in projected rural support earmarked for CETCs in fourth quarter 2004. This demonstrates that large wireless carriers are able to receive rural ILEC high-cost support, using the identical support rule, with no demonstration of their own costs, no accounting for their own economies of scale and scope, and no showing that their costs exceed a national benchmark average that would either qualify or disqualify them to be even eligible for support.

Both rural wireless carriers with less than 100,000 connections within a state and larger wireless carriers do not have the same costs or regulatory obligations as rural ILECs. Wireless carriers neither provide the same quality of local service or interstate access services to consumers. Wireless carriers do not have carrier of last resort obligations. They do not use the same type of facilities to provide the services. Wireless CETCs do not have high-cost loops and do not provide ubiquitous local service. They also do not have the interstate access costs relevant to the interstate common line support (ICLS) mechanism because they have no wireline local loops on which the ICLS mechanism is based. And, unlike rural ILECs, wireless CETCs do not offer equal access to all long distance carriers and hence wireless CETC costs for providing access to a single long distance carrier are likely substantially lower than the rural ILEC's costs. Thus, "rural wireless carriers" designated as CETCs in a rural ILEC study area, should not receive the identical per-line support as the ILEC, based on the ILEC's costs.

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[34] Universal Service Administrative Company (USAC).
[35] OPASTCO Comments, p. 6, referencing the Universal Service Administrative Company, *Federal Universal Service Fund Size Projections from the Fourth Quarter 2004* (August 2, 2004), Appendices HC01 and HC18.

NTCA believes that the proposed rule changes are more consistent with competitive neutrality than the positions urged by wireless carriers who want to retain the identical support rule. The changes will enable the FCC to more effectively manage the future growth of the high-cost fund as well. With the elimination of the identical support rule and allowing all wireless CETCs the option to base their universal service support on their own costs, the FCC will be better able to ensure that support to a wireless CETC is not excessive and used for the purposes intended as required by Section 254(e) of the Act.[36]

V. THE COMMISSION SHOULD EITHER ELIMINATE THE PARENT TRAP RULE OR MODIFY THE SAFETY VALVE RULE TO PROVIDE CARRIERS SUPPORT BASED ON THEIR FIRST YEAR INVESTMENT IN ACQUIRED EXCHANGES

A. Proponents Of 54.305 Fail To Show That It Complies With Section 254.

NTCA, ITTA, and USTA have urged the Joint Board to either eliminate or modify 47 C.F.R. § 54.305 (known as the parent trap rule) which limits the support that a purchasing carrier can receive for exchanges acquired from another carrier based on the selling carrier's pre-transfer level of support for the transferred exchanges.[37] Sprint and Tri-County Telephone Association have requested that the parent trap rule should remain unchanged.[38] The Joint Board should dismiss the arguments by Sprint and Tri-County and recommend that the Commission either eliminate the rule or adopt the proposed modification of the safety valve rule contained in NTCA's July 5, 2001 petition for reconsideration of the rule.[39]

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[36] 47 U.S.C. § 254(e).
[37] See Comments filed by NTCA, p. 12, ITTA, p. 30, and USTA, p. 13.
[38] See Comments filed by Sprint, p. 9, and Tri-County Telephone Association, p. 10.
[39] *See*, NTCA's Petition for Reconsideration and Clarification, CC Dockets No. 96-45 and 00-256 (filed July 5, 2001), and NTCA's Reply to Oppositions to its Petition for Reconsideration, CC Docket No. 96-45 (filed August 10. 2001).

Tri-County admits "the condition of many exchanges owned by larger companies does not measure up to the standards expected in the United States."[40] It claims, however, that allowing the purchasing carrier to obtain support "only places the burden of neglect on the broader body of rate paying Americans."[41] Tri-County believes that this is "an abuse of the support mechanism."[42] Tri-County is correct that many of the exchanges purchased from large carriers have been neglected for many years. Tri-County, however, is incorrect in its allegations about abuse of the mechanism.

It is not an abuse to allow an acquiring carrier to receive sufficient support to provide rural consumers in an acquired exchange with comparable rates and quality services as compared to urban consumers. Indeed, these principles are contained in Section 254 of the Telecommunications Act of 1996.[43] In addition, it is not abuse to require a broader body of ratepayers and providers to contribute to universal service so that "all people of the United States" have access to "adequate facilities at reasonable charges." Section 1 of the Communications Act of 1934 requires it.[44]

Sprint claims that the parent trap rule should remain in place because "requiring an acquiring ILEC to receive the same amount of USF per-line support as that received by the divesting LEC, in addition to the Commission's safety valve provisions for rural ILECs, serves to minimize the impact of USF in an acquisition or divestiture decision."[45] Sprint is wrong. Market forces, not USF, largely determine the decision to purchase an exchange from a large

[40] Tri-County Comments, p. 10.
[41] *Id.*
[42] *Id.*
[43] 47 U.S.C. § 254.
[44] 47 U.S.C. § 151.
[45] Sprint Comments, p. 9.

LEC instead of overbuilding or serving customers with a new technology. A range of factors goes into the acquisition decision. The future business opportunities and the level of competition in the targeted exchange are the major considerations. Most rural areas are already served by an average of more than three wireless carriers.[46] Rural carriers are also facing growing competition from cable, VoIP, municipal and satellite communications providers. These forces plus the cost of new communications technologies are major considerations when determining whether a rural ILEC can acquire an exchange. Small carriers that undertake these risks in order to serve rural consumers should not be penalized or treated differently from those that are already serving rural customers.

Any additional support for purchasing carriers should be driven by post-transaction investments made to enhance the infrastructure of and improve the service in these exchanges.[47] This is consistent with Section 254(b)(3) which states that "[c]onsumers in all regions of the Nation ...should have access to telecommunications ...services ...that are reasonably comparable to those services provided in urban areas ..." Denying support for acquired exchanges for an entire year is unfair to both consumers and the rural carriers trying to provide improved services in these rural high-cost areas.

B. The Parent Trap And Safety Valve Rules Do Not Provide Sufficient Support.

The combined application of the parent trap rule and safety valve rule do not provide rural ILECs any universal service support for their first year investments in newly acquired

[46] *Seventh Annual CMRS Competition Report*, 17 FCC Rcd 13,023.
[47] *See Rural Task Force Recommendation*, p. 30, Letter from William R. Gillis, Chair, Rural Task Force, to Magalie Roman Salas, FCC, dated September 29, 2000 (Rural Task Force Recommendation).

exchanges.[48] The first year is typically the greatest year of investment for rural ILECs in their effort to upgrade old and inefficient equipment because the first year of operating an acquired exchange is the year that rural consumers are most eager and expect new and improved communications services. It is also the most significant year for the carrier to establish a good working relationship with consumers living in the newly acquired exchange. It is the first time that consumers in acquired exchanges are introduced to their new telecommunications services provider and form their opinion of new provider's quality service and customer responsiveness. Without sufficient support to assist rural carriers during the first year to implement necessary upgrades to acquired exchanges, the acquiring carrier's first year of operations can result in continued poor service and consumer disdain.

Furthermore, the forces behind large company sales of rural exchanges demonstrate why not only an amendment to the safety valve rule but complete repeal of rule 54.305 is needed. The averaging methodologies employed in the telecommunications industry prior to the divestiture of AT&T and prior to the 1996 Act were an implicit form of support provided to high cost rural exchanges served by the large regional Bell operating companies (RBOCs). These average rate structures permitted full recovery of cost for the RBOCs as long as they were regulated under rate-of-return and, on an overall basis, earned an adequate return on their

[48] *Federal-State Joint Board on Universal Service; Multi-Association Group (MAG) Plan for the Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers,* Federal Register, Vol. 66, No. 108, Final Rules, 47 C.F.R. 54.305(c) (June 5, 2001).

investment. When the RBOCs became subject to competition and incentive regulation, however, averaging did not result in upgrades in their high cost rural exchanges. As CenturyTel has found:

> Having purchased hundreds of thousands of rural exchange lines from larger carriers, CenturyTel has observed that rural exchanges are often in areas where selling carriers have invested the least; thus, significant improvements to the infrastructure are needed following the transfer. Moreover, a year or more may sometimes lapse between the time that the seller decides to sell the exchanges and the actual closing, which allows the exchanges to fall into further decline. By delaying the distribution of the safety valve support for a year, the Commission's current rules simply encourage further neglect of rural exchanges following transfer. Rather, the Commission's rules should encourage acquiring carriers to begin providing improved services to rural customers immediately following acquisition.[49]

In the long run, a public policy encouraging independent companies to acquire rural exchanges no longer wanted by large LECs will improve the service provided and increase the cost effectiveness of the rural network. This approach, over time, would lower the amount of universal service support otherwise required in these rural exchanges. NTCA urges the Joint Board to recommend that the Commission either eliminate the parent trap rule or adopt NTCA's proposed modification to the safety valve rule.[50]

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[49] *Comments of CenturyTel, Inc.*, CC Docket Nos. 96-45 and 00-256, p. 4 (July 31, 2001).

[50] *See*, NTCA's Petition for Reconsideration and Clarification, CC Docket No. 96-45 (filed July 5, 2001), and NTCA's Reply to Oppositions to its Petition for Reconsideration, CC Docket No. 96-45 (filed August 10. 2001). Amending the safety valve rules to permit safety valve support in the first year of acquisition will allow for this to happen and ensure that the objective of Section 254(b)(3) is met during the first year of acquisition. This can accomplish by defining the index year expense adjustment as the selling carrier's expense adjustment at the time of the sale of the exchange. The acquiring carrier's first year expense adjustment for the acquired exchange should then be compared to the seller's index year expense adjustment to determine any positive difference eligible for safety valve support in the acquiring carriers first year of operations. NTCA's proposed modification to the rule will provide the appropriate incentive for rural carriers to invest in acquired exchanges and assist the Commission in its efforts to ensure rural consumers receives comparable rates and services as required by the Act.

VI. THE CORPORATE OPERATIONS EXPENSE ADJUSTMENT SHOULD REMAIN AS PART OF THE RURAL HIGH-COST LOOP SUPPORT MECHANISM

In its initial comments, NTCA urged the Joint Board to retain the current corporate operations expense adjustment for rural ILECs. The corporate operations expense adjustment represents legitimate costs of doing business and the costs of providing supported services to rural areas, hence the adjustment is critical for small, rural carriers.

Nextel Communications, Inc. claims that "the 'corporate operations expenses' category is aimed at the recovery of general expenses that are not related to the provision of the nine core services for which Universal Service support is intended."[51] To the contrary, corporate operations expenses are necessary for providers to be able to provide any service whatsoever. They are legitimate costs of doing business, and typically impose a greater burden on smaller carriers than on larger carriers. Continuing to allow rural carriers to receive support for these expenses will in turn allow them to continue to provide the nine supported services to their rural customers at comparable prices to urban consumers.

Similarly, CTIA says that corporate operations expenses are "unrelated to installing and maintaining plant and equipment"[52] and thus should be "remove[d]…from the high-cost support mechanisms."[53] CTIA is wrong. As noted previously, these expenditures allow carriers to remain viable—without them, the company would not be able to function and hence could not install and maintain plant and equipment. In that sense, they are just as important in facilitating the provision of universal service as direct expenditures on plant and equipment.

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[51] Nextel Communications comments, p. 10.
[52] CTIA comments, p. 11.
[53] *Id.*, p. iv.

Lastly, Western Wireless claims that "the [rate-of-return] ROR-based universal service funding system…enables some rural ILECs to incur excessively high 'corporate operations' overhead costs and to reap large universal service payments as a result …."[54] The Western Wireless claims are without merit. As Lehman shows in his White paper, the Western Wireless/ETI study on the corporate operations expense adjustment is fundamentally flawed.[55] The ETI study's premises are false, its conclusions do not follow from its analyses, and the conclusions themselves are poor universal service policy. The availability of telecommunications services in rural areas would be jeopardized if the Commission adopted the suggestions of ETI. The real purpose of the Western Wireless/ETI study is to divert attention away from a major threat to universal service. The fact that Western Wireless and other large wireless CETCs are currently able to receive rural high-cost universal service support under the guise of the identical support rule without ever demonstrating their costs or justifying their eligibility for support.

VII. LOCAL SWITCHING SUPPORT FOR SMALL COMPANIES SHOULD BE RETAINED

Problems associated with growth of the fund need to be addressed along side questions related to the base of contributors. In its initial comments NTCA urged the Joint Board to recommend the Commission continue to provide local switching support (LSS) to carriers serving 50,000 or fewer lines. NTCA demonstrated that switching costs continue to disproportionately impact smaller companies and thus LSS should be retained for rural ILECs.

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[54] Western Wireless comments, p. 18.

[55] *False Premise, False Conclusions – A Response to an Attack on Universal Service,* By Dale Lehman, Filed in CC Docket 96-45 by NTCA and OPASTCO on August 5, 2004.

CTIA advocates "reduc[ing] the threshold to qualify for local switching support from 50,000 access lines in a state to a lower number and/or limit[ing] support to those incumbent LECs with higher than average switching rates."[56] Nextel also proposes a reduction in the threshold for local switching support from 50,000 lines to 25,000 lines, but suggests that the Joint Board protect carriers with higher than average switching costs by "consider[ing] a 'safety valve' mechanism that will allow those carriers to receive some switching support …."[57] And Western Wireless similarly recommends reducing the threshold from 50,000 to 25,000 lines, in order to "reflect economies of scale that can be achieved by carriers with fewer than 50,000 lines."[58]

NTCA opposes such measures. CTIA, Nextel and Western Wireless offer no evidence justifying a threshold change. The fact remains that small carriers continue to face higher average switching costs than their larger counterparts. Requiring those carriers with between 25,000 and 50,000 lines to justify their need for LSS would only add an unnecessary administrative burden to these companies' operations. Moreover, reducing the threshold will only serve to harm those companies who face higher switching costs solely as a consequence of their small size. As NTCA illustrated in its initial comments, switching costs for small companies are, on average, dramatically higher than for larger companies.[59] For these reasons, the Joint Board should recommend the Commission continue to provide local switching support to carriers serving 50,000 or fewer lines.

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[56] CTIA comments, p. iv.
[57] Nextel comments, p. 12.
[58] Western Wireless comments, p. 37.
[59] NTCA comments, p. 12.

VIII. THE JOINT BOARD SHOULD RECOMMEND EXPANSION OF THE BASE OF CONTRIBUTORS TO INCLUDE CABLE, WIRELESS AND SATELLITE PROVIDERS OF BROADBAND INTERNET ACCESS, AND FACILITIES-BASED AND NON-FACILITIES-BASED VoIP AND IP-ENABLED SERVICE PROVIDERS

The Commission has the authority to expand the number and types of contributors to the fund to ensure "sufficient" support to achieve the goals of the Act. NTCA believes that the time is ripe for the Commission to expand the list of contributors to include both facilities-based and non-facilities-based voice over Internet protocol (VoIP) and IP-enabled service providers, and all cable, wireless and satellite providers of broadband Internet access and other providers that connect to or benefit from connection to the public telephone network, regardless of the classification of the service as an information service, telecommunications service or private carriage service.

Cable, wireless and satellite communications companies are currently using their platforms to provide broadband Internet access service in direct competition with incumbent ILEC broadband access service. None of these non-LEC broadband access providers, however, have the same universal service obligations as their ILEC competitors. Contribution policies and rules therefore should change in order to eliminate the distinct competitive advantage these companies have over contributing ILECs, as well as the drain they impose on the interstate revenue assessment base.[60]

The technology that consumers want and expect to have access to is changing. As Congress anticipated, the current definition of universal service must evolve to keep pace with the consumer need. Universal service support ensures comparable and affordable services throughout the nation. Cable, wireless and satellite providers of broadband Internet access and

[60] *First Repost and Order,* CC Docket 96-45, 12 FCC Rcd 9183-9184, ¶ 795.

VoIP/IP-enabled service providers will interconnect with or utilize the public telephone network and benefit from this nationwide network made possible by universal service. They should therefore all contribute to the universal service funding mechanisms. Expanding the list of contributors to the fund will be critical to this Nation's continued success in providing all Americans, rural and urban, access to affordable and comparable communications services.

IX. CONCLUSION

A decision on a mechanism for the future funding of support for rural telephone companies is part of a wider set of issues, including reform of intercarrier compensation, the President's pronouncement that broadband should be made available to all Americans by 2007 and the possibility that the next Congress will begin deliberating a rewrite of the Communications Act. The Joint Board should therefore retain the existing embedded cost mechanism in the interest of preserving a stable environment for investment in high-cost rural areas and the maintenance of universal service in the interim during which fundamental changes in the industry could occur. It would be counter-productive to engage huge resources in a debate over embedded cost versus forward-looking economic costs during a time when other changes may make this debate a moot issue. For these reasons, NTCA urges the Joint Board to recommend that the Commission:

(1) refrain from applying a forward looking economic cost model for determining high-cost universal service support for rural ILECs;

(2) retain the current definition of a "rural telephone company" at this time for purposes of determining which rural ILECs are eligible to receiving rural high-cost universal service support;

(3) allow the rural ILEC USF embedded cost methodology to continue beyond the five-year RTF plan for purposes of determining rural ILEC high-cost support;

(4) eliminate the identical support rule and require CETC support to be based on CETC costs, not ILEC's costs;

(5) continue to calculate rural ILEC support based on the individual carrier's study area average costs;

(6) retain the current corporate operations expense adjustment;

(7) continue to provide local switching support to rural telephone companies with 50,000 or fewer lines;

(8) modify the safety valve rule to provide carrier support for an acquiring carrier's first year investment in acquired exchanges; and

(9) expand the base of USF contributors to include all cable, wireless and satellite providers of broadband Internet access and facilities-based and non-facilities-based VoIP and IP-enabled service providers.

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December 14, 2004

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